

**STATEMENT OF**  
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**UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY**  
**AND**  
**DIRECTOR OF THE UNITED STATES PATENT AND TRADEMARK OFFICE**  
**BEFORE THE**  
**COMMITTEE ON THE JUDICIARY**  
**U.S. House of Representatives**  
**Legislative Hearing on H.R. 9, the "Innovation Act"**  
**APRIL 14, 2015**

**INTRODUCTION**

Chairman Goodlatte, Ranking Member Conyers, and Members of the Committee: Thank you for this opportunity to appear before the Committee to discuss H.R. 9, the Innovation Act.

Patent rights are an important driver of technological innovation. The United States is fortunate to have robust protections for intellectual property rights that include a strong patent system. I say this with first-hand knowledge of how important patents can be in incentivizing innovation and creating economic growth. I was born and raised in the Silicon Valley and spent most of my career there. I grew up on a street filled with engineers. Patents allowed these innovators to obtain financing to build companies that took their inventions to the marketplace. Since that time, I have been fortunate to have had a career of my own involving technology, innovation, and our intellectual property system. Prior to law school, I worked as a computer programmer in leading research laboratories. After law school, I clerked for judges who handled patent cases at the trial and appellate court levels. I was also a partner in private practice, where I represented patent applicants and litigants, licensees and licensors, for a wide range of clients, before becoming head of patents and patent strategy at a leading high technology company.

I have prosecuted patents, asserted patents, defended against patent infringement allegations, and licensed, bought, and sold patents in a wide range of technologies. So I understand, from a business perspective, the critical value patents can have for a company looking to enter a market crowded with competitors, as well as the cost to society when a patent issues that should not have. Today I have the privilege of bringing this diverse set of perspectives to bear on the well-being of the entire intellectual property system. As Director of the United States Patent and Trademark Office, I am charged with approaching intellectual property as a steward, ensuring that our nation's intellectual property system continues to promote innovation for the benefit of our society.

## OVERVIEW

As the Committee is aware, the past several years have seen the growth of patent litigation practices which have the potential to hurt innovation. These abusive litigation practices can be particularly harmful to new and small businesses, which often lack the resources to defend themselves in these often highly complex and expensive cases. There have been reports of widespread mailing of “demand letters” with vague allegations of patent infringement to people otherwise unfamiliar with patents and patent law. In addition, there is a continuing need to find ways to strengthen the patent system by leveling the playing field for innovators and increasing the transparency of patent ownership information.

Since December 2013, when the House of Representatives passed the Innovation Act, H.R. 3309—which is identical to the bill we address here today—there have been a number of changes to the patent landscape. At the USPTO, we have been busy implementing the new post-issuance proceedings created by the Leahy-Smith America Invents Act, Pub. L. No. 112-29 (2011) (“AIA”). Since these proceedings began, the USPTO has received more than 3,000 petitions—almost three times the number originally projected. The AIA granted the USPTO authority to implement these proceedings within Congress’s statutory framework, and we have done so. We always expected that our first iteration of rules would need to be perfected in light of experience. Last spring, we launched an eight-city, nation-wide listening tour, followed by a request for formal written comments. We have now received comments in a number of areas including: discovery, claim construction standards, amendments, hearings that involve live testimony, patent-owner preliminary responses, coordination of multiple proceedings, identification of real-parties in interest, and the composition of the panels of administrative patent judges. After consideration of all the comments, the USPTO has just implemented a set of “quick fixes,”<sup>1</sup> and will issue a series of proposed revisions to the existing rules and to its Trial Practice Guide later this year.

In addition, thanks to the AIA, the USPTO has launched an Enhanced Patent Quality Initiative<sup>2</sup> to focus on further improving patent quality, starting with a recent two-day summit at our headquarters in Alexandria.

Other changes to the patent landscape have stemmed from the actions of the courts, the Judicial Conference of the United States, the Federal Trade Commission, state legislatures, and state attorneys general. Many of these actions have made progress in clarifying patent rights and curtailing some patent litigation abuses, but they are not a complete solution. The recent judicial decisions are limited in their effect because of the limitations of the statutes that those cases interpret. And other actions – particularly the passage of some state laws – have added to the need for federal legislation that provides a uniform national approach. The USPTO also believes that legislation remains necessary to realize the full potential of the changes enacted in the AIA. Although the AIA made a large number of important reforms to the patent system, that law did

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<sup>1</sup> For more information, please see <[http://www.uspto.gov/blog/director/entry/ptab\\_s\\_quick\\_fixes\\_for](http://www.uspto.gov/blog/director/entry/ptab_s_quick_fixes_for)>.

<sup>2</sup> Request for Comments on Enhancing Patent Quality, 80 Fed. Reg. 6475 (February 5, 2015) (announcing this initiative). For additional information, please see <<http://www.uspto.gov/patent/initiatives/enhanced-patent-quality-initiative>>.

not address all currently outstanding problems—some of which have become more apparent since the AIA’s enactment.

## INNOVATION ACT PROVISIONS

Upon careful consideration of these issues, and in light of the changes that have happened in the patent system, the USPTO believes that legislation to curtail abusive patent litigation is necessary and appropriate at this time. Of course, any legislative reform must preserve a patentee’s ability to reliably and efficiently enforce its patent rights. Legislation must achieve a balance, preventing abuse while ensuring that any patent owner, large or small, will be able to enforce a patent that is valid and infringed. With these principles in mind, the USPTO offers the following comments on the provisions of H.R. 9.

### *Attorney’s Fees*

The USPTO generally supports the approach taken in § 3(b) of H.R. 9, which would require an award of attorney’s fees and expenses to be made to the prevailing party in a patent case upon a motion by that party unless the non-prevailing party’s litigation position or conduct was reasonably justified in law and fact. This proposal would create a fault-based standard under which fees and expenses would be awarded in appropriate cases but would not be automatic. Rather, an award would be made only if the court finds that the non-prevailing party’s litigation position was one that no reasonable litigant would have believed would succeed, or that the non-prevailing party’s conduct was otherwise unreasonable.

The substantive standard that this proposal would codify is generally consistent with that already being applied in at least some district courts pursuant to the Supreme Court’s recent decision in *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749 (April 29, 2014). In *Octane*, the Supreme Court interpreted current law’s authorization to make awards in “exceptional” cases, and clarified that “an ‘exceptional’ case is simply one that stands out from others with respect to the substantive strength of a party’s litigating position (considering both the governing law and the facts of the case) or the unreasonable manner in which the case was litigated.” *Id.* at 1756. Relying on *Octane*, some district courts have awarded fees on the basis that the non-prevailing litigant advanced legal and factual theories that no reasonable litigant would advance or that otherwise lacked a reasonable basis, or engaged in unreasonable litigation tactics and conduct.

However, under the current statutory regime as interpreted by the Supreme Court, district courts retain wide discretion to determine whether a case is exceptional. In particular, district courts have discretion to deny a fee award even after finding that a case is exceptional. Accordingly, some courts may decline to award fees in circumstances when other courts would do so. This uncertainty makes it more difficult for parties to decide whether to vindicate their rights through to a final decision in cases where the other side’s position appears indefensible. Section 3(b) of H.R. 9 would help bring consistency and predictability to this area of the law by codifying a standard (namely unreasonable conduct or unreasonable positions) for when courts would be required to award fees.

This provision would apply equally to plaintiffs and defendants. Accordingly, just as a defendant would be awarded fees when the plaintiff's infringement position was unreasonable, a plaintiff would also be entitled to fees when there is no reasonable dispute that a patent is valid and infringed. The USPTO thus believes that the approach taken along the lines of § 3(b) of H.R. 9 is needed and would help curtail litigation abuses committed by plaintiffs and defendants because it would encourage each side to prepare and analyze their cases responsibly. The USPTO also believes, however, that the party seeking a fee award—the prevailing party—should bear the burden of demonstrating that it is entitled to such an award.

Finally, § 3(b) of H.R. 9 appropriately preserves some judicial discretion—and allows courts to prevent inequitable results—by authorizing a court to deny a fee award in special circumstances. For all these reasons, the USPTO believes that § 3(b) of H.R. 9 generally strikes the right balance between discouraging inappropriate litigation while increasing the likelihood that patentees can vindicate their rights.

### *Pleading Requirements*

The USPTO supports heightening pleading requirements in patent infringement cases beyond what is currently required to ensure that defendants have—as soon as the case is filed in court—a basic understanding of why they are allegedly infringing a patent. Thus, the USPTO generally supports the requirement in § 3(a) of H.R. 9 that a complaint explain how each element of a patent claim is met by an accused product or process, or address why such information is not readily accessible. The USPTO believes that requiring an identification of the allegedly infringing products and an explanation of how they infringe at least one claim of each asserted patent would provide needed notice to accused infringers.

Any requirement to plead additional claims in a patent at this early stage of litigation should be considered in light of the burdens that it would place on the patent owner, the potential that it creates for procedural motions that do not materially advance the case, and the incentive that it creates to “overplead” marginally relevant patent claims. Pleading requirements should account for the fact that a party often lacks a complete understanding of the case at the time the complaint is filed. The parties’ understanding evolves as the case develops, and it might become apparent that a patent claim other than that which is asserted in the complaint is the most suitable vehicle for relief.

### *Discovery*

The USPTO believes that any changes to discovery rules should facilitate the early resolution of disputes, avoid needless costs, and promote efficiency and fairness. The USPTO supports § 6 of H.R. 9, under which the Judicial Conference of the United States would develop rules and procedures that would address the asymmetries in discovery burdens and costs in patent cases. The Judicial Conference has already recommended that the Supreme Court adopt changes to the Federal Rules of Civil Procedure to promote discovery “proportionate” to the needs of a case, and we believe building on that work would be productive.

Section 3(d) of H.R. 9 stays discovery in patent cases pending a ruling by the court on claim construction, except for that discovery which is necessary for construing the claims. Patent claim construction can be complex. Often, absent some understanding of validity and infringement issues via discovery, knowing which terms to construe and adequately construing such terms can be difficult. Limited discovery on these issues can often help crystallize aspects of a patent claim that are important to resolution of a given case, and can even facilitate early settlement. For this reason, numerous district courts, such as the Northern District of California, have established local patent rules requiring early disclosure of contentions of infringement and invalidity alongside production of a targeted set of documents.

Moreover, claim construction alone often is not dispositive of a patent case. It can be difficult to win an early summary judgment motion without some discovery, even if there is a claim construction ruling. And where a case continues after claim construction, discovery would also proceed. In such cases, the proposal of § 3(d) of H.R. 9 would not avoid discovery, but simply delay or duplicate it.

Other features of H.R. 9 will likely help to address some of the current abuses that may occur during discovery. Increasing the chances that attorney's fees and litigation expenses are awarded against litigants advancing unreasonable cases will help curtail the ability of both abusive plaintiffs and defendants to coerce settlement through imposition of high discovery costs on the opposing party. And, heightened pleading requirements will help to focus discovery. The USPTO also believes there may be better alternatives for achieving the goal of reducing excessive discovery in patent litigation cases, and would welcome the opportunity to work with the Committee and stakeholders to develop such proposals.

### *Stays of Customer Suits*

The USPTO generally supports § 5 of H.R. 9, which would allow consumers and retailers of off-the-shelf products to agree to have the manufacturer of the product litigate a patent infringement suit concerning the product. Infringement suits against the consumer or retailer would be stayed while the manufacturer's action proceeds. Such lawsuits against consumers for using a product, or against retailers for selling a product, are often coercive and almost always inefficient. By staying the suit against the customer or retailer while a manufacturer suit is litigated, § 5 places the party that is in the best position to understand the accused product and its technology in charge of defending the lawsuit.

In exchange for having its case stayed, however, the consumer or retailer should be required to agree to be bound by the result of the manufacturer's suit. Absent this requirement, a patentee might have to litigate a case against a manufacturer, prevail, then need to bring an entire second suit against the customer if such further suit is needed to make the patentee whole. Importantly, if a customer or retailer believes that its interests will not be adequately represented in the manufacturer's action, it does not have to agree to a stay. Also important to any stay proposal is a requirement that the defending parties all consent to the stay. A stay should be entered only if the customer or retailer and the manufacturer agree. This requirement protects a defendant manufacturer in scenarios where the "customer" is not simply an off-the-shelf

purchaser, but rather a sophisticated purchaser whose instructions and specifications to the manufacturer may have caused the alleged infringement.

Finally, any proposal should make clear that a stay remains within a court's equitable discretion in other situations not directly addressed by the proposal. At common law, courts currently enjoy the authority to enter a stay in other circumstances where the equities so require, such as those involving component manufacturers and intermediate suppliers.

### *Transparency of Patent Ownership*

The USPTO generally supports § 4 of H.R. 9, which would require certain mandatory disclosures of patent ownership when a patent is enforced through litigation. This would allow an accused infringer to understand who, besides the named plaintiff, may have an interest in the litigation. Such enhanced transparency may facilitate settlement of litigation—and, importantly, help ensure that a settlement is as comprehensive as desired between the parties.

The USPTO recommends, however, that the Committee ensure that an accused infringer knows who is truly behind a lawsuit, but avoid requiring the gathering of information that may provide little benefit to the parties. In addition, the section as currently written requires disclosure only by a plaintiff—thereby apparently exempting from its requirements a party that asserts infringement only in a counterclaim. Disclosure should be required any time a patent is asserted in litigation.

The USPTO would also support a general requirement that ownership information be periodically updated at the USPTO for all patents even before litigation, though it remains for further discussion what level of detail and periodicity might be most appropriate. The public would benefit the most from having access to ownership information at the USPTO before an infringement suit is filed to better inform licensing and patent clearance activities could take place.

### *Demand Letters*

The USPTO shares the view expressed in § 3(e) of H.R. 9 that it is an abuse of the patent system to send purposely evasive demand letters to end users alleging patent infringement. It is important that any demand letter legislation be reasonably-tailored and balanced to preserve patent owners' abilities to license their patents in good faith.

The USPTO also believes that there is a growing need for a national approach to demand letter regulation. At least eighteen states have recently enacted laws that govern patent demand letters, and bills are pending in others. These state laws impose a variety of requirements for patent demand letters, creating a patchwork regime that makes nationwide compliance with these laws extremely challenging. A national standard that promotes uniformity would address these concerns and encourage the transfer of patented technology from universities, companies and individual inventors for use in society.

## *Recovery of Attorney's Fees*

The USPTO supports the principle embodied in § 3(c) of H.R. 9 that an abusive litigant should not be allowed to insulate itself from accountability under § 285 of title 35 by carrying out its patent-enforcement activities via a “shell” entity that will be unable to satisfy a fee award. Section 285, as amended by § 3(b) of H.R. 9, would deter parties from advancing unreasonable litigation positions or engaging in abusive tactics. That deterrent effect would not be fully realized if a party that profits from and controls the litigation could nevertheless readily immunize itself from § 285 liability by operating through limited-liability entities.

While there seems to be general agreement on these principles, implementing them through legislation is difficult. The limited liability of corporate employees and shareholders is a long-established feature of American law. Overriding it may serve as a substantial deterrent to investment in new enterprises and potentially job creation, particularly a number of high-growth sectors. Individual investors, for example, may not be willing to invest in a start-up company if the risks of doing so included not just the loss of their initial investment, but also personal liability to the investor for the company's subsequent patent litigation decisions.

Legislation should be narrowly drawn with clear boundaries. Given the relatively low number of fee awards that were made before last year's decision in *Octane Fitness*, there currently is little public evidence of what tactics abusive litigants may use to evade enforcement of awards.

With these principles in mind, it would be helpful to clarify § 3(c)'s definition of the entities that are subject to joinder—those with “no substantial interest in the subject matter at issue other than asserting such patent claim in litigation.” It is unclear, for example, whether the named inventor would have a “substantial interest” in the subject matter simply because she invented the subject matter. In addition, to help ensure that the prospect of joinder does not chill investment in new companies, § 3(c) should include some kind of clear exemption for passive investors—those who lack the ability to direct or control a company's litigation. Such an exemption would better allow an investor to know whether investing in a company may subject her to personal liability.

## *Other Provisions*

Section 9(b) of H.R. 9 would require the USPTO's Patent Trial and Appeal Board (“PTAB”) to interpret patent claims in AIA trials as they would be construed in district court litigation, rather than based on their broadest reasonable interpretation. If legislation were to direct the PTAB to employ the district court approach to claim construction in AIA trials, consideration should also be given to repealing the right to amend claims in those proceedings consistent with the historical use of these two standards.

Other provisions of H.R. 9 include important changes including provisions to protect patent licenses in foreign bankruptcy proceedings and to clarify the estoppel effect of post-grant

review proceedings. Additional provisions, such as those addressing double patenting and patent term adjustments, should be revisited in light of recent case law development.

## CONCLUSION

To summarize, the principles that the USPTO supports would help curtail abuses and increase transparency in our patent system as well as level the playing field for innovators, while preserving the right of patent owners to legitimately exercise their patent rights when needed. Specifically and collectively, the package of legislative proposals supported by the USPTO would: (1) provide the financial incentives to pursue meritorious claims and defenses, but not more; (2) increase the notice provided both in demand letters and complaints in patent disputes; (3) help focus discovery, including by heightening pleading requirements and shifting fees in unreasonable cases; (4) protect customers and retailers while the manufacturer of the allegedly infringing product litigates the dispute; (5) provide important ongoing license rights to U.S. patents repudiated or rejected in a foreign bankruptcy proceeding; and (6) increase transparency of patent ownership information.

The USPTO appreciates the momentum toward these goals that H.R. 9 represents. We look forward to working with members of the House and Senate and all stakeholders both on this specific legislative effort, and in the ongoing effort to achieve meaningful and balanced reforms. Such reforms will necessarily take into account the many recent changes to our patent system resulting from recent court rulings addressing fee-shifting, patent eligible subject matter and other issues; the admirable work by many district court judges to actively manage their patent cases; the Judicial Conference's proposed rule changes; and the USPTO's continued implementation and refinement of the AIA post-grant review proceedings, its work on the Enhanced Patent Quality Initiative, and its implementation of seven White House Executive Actions.<sup>3</sup>

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<sup>3</sup> For more information, please see < <http://www.uspto.gov/patent/initiatives/uspto-led-executive-actions-high-tech-patent-issues> > and <<http://www.uspto.gov/patent/initiatives/enhanced-patent-quality-initiative>>.